K C Mehta & Co LLP
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kcm NETWORK

kcmCompass

Macro-Economic Analysis

Indian Economic Survey

July 2024

Introduction

Introducing ***kcm*Compass** - a new series of publication from KCM, offering periodic economic updates. Through this series, we aim to offer a detailed analysis of the period gone by from a macro-economic perspective, studying the performance of various important economic metrices, understanding the Government's policies around the same, and analysing the impact of both on people and business.

What we will be talking about here are all everyday concepts that make it to the daily headlines – '**Inflation** surges to a four-month high', 'India's **forex reserves** jump', 'India to be the fastest **growing economy**', 'What the new **consumption pattern** can mean for inflation', etc.

However, through this publication, we aim to connect the dots between these otherwise abstract economic terminologies that have huge interdependencies and impact all our lives some way or the other. A business executive for instance might be concerned with income levels and consumption pattern in the economy to be able to forecast demand; while senior citizens would be worried about the inflation trends and rise in prices of essential commodities; working professionals on the other hand would look out for what is happening in the job market and what the Government is doing towards skill development and job creation.

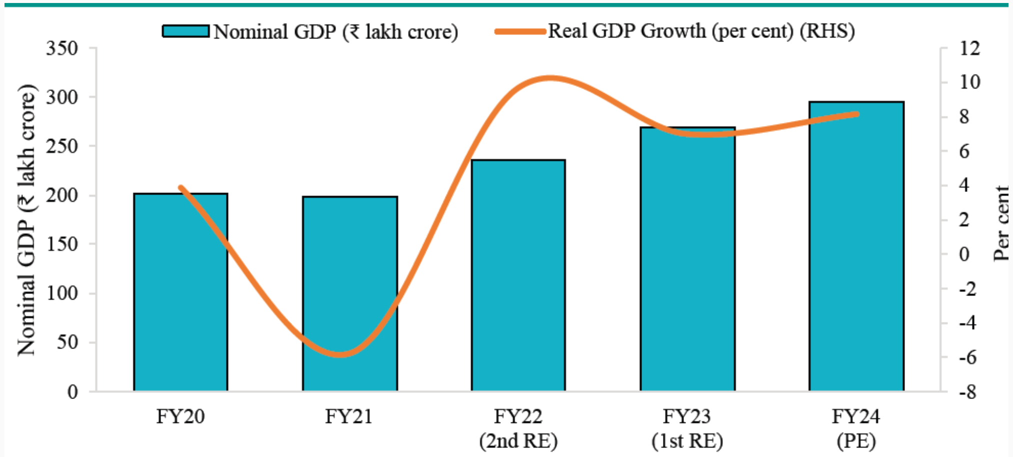
With that, we are pleased to present the very first ***kcm*Compass**, covering the last **financial year 2023-24**. Since the budget has just come out, we would dedicate this first publication to how the economy performed last year and how the budget has responded to it.

Economic Overview FY24 - *What has happened so far…*

Indian economy shows signs of recovery; but is it broad based?

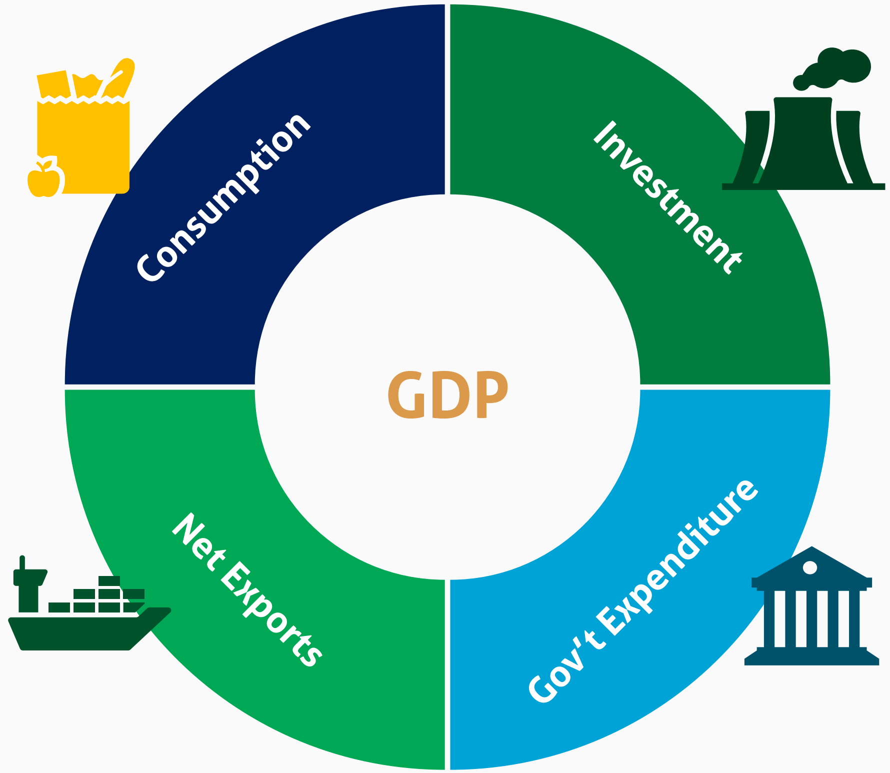
- GDP growth has normalised at pre pandemic levels in FY24 after observing some severe fluctuations.
- The nominal GDP grew from Rs. 200 lakh crore in FY20 (the last pre-pandemic year) to Rs. 295 lakh crore in FY24.
- This marked a YoY ***GDP growth*** rate of ***8.2% in real terms in FY24*** as against growth of 5% in FY20.

GDP Growth



Source: Economic Survey 2023-24

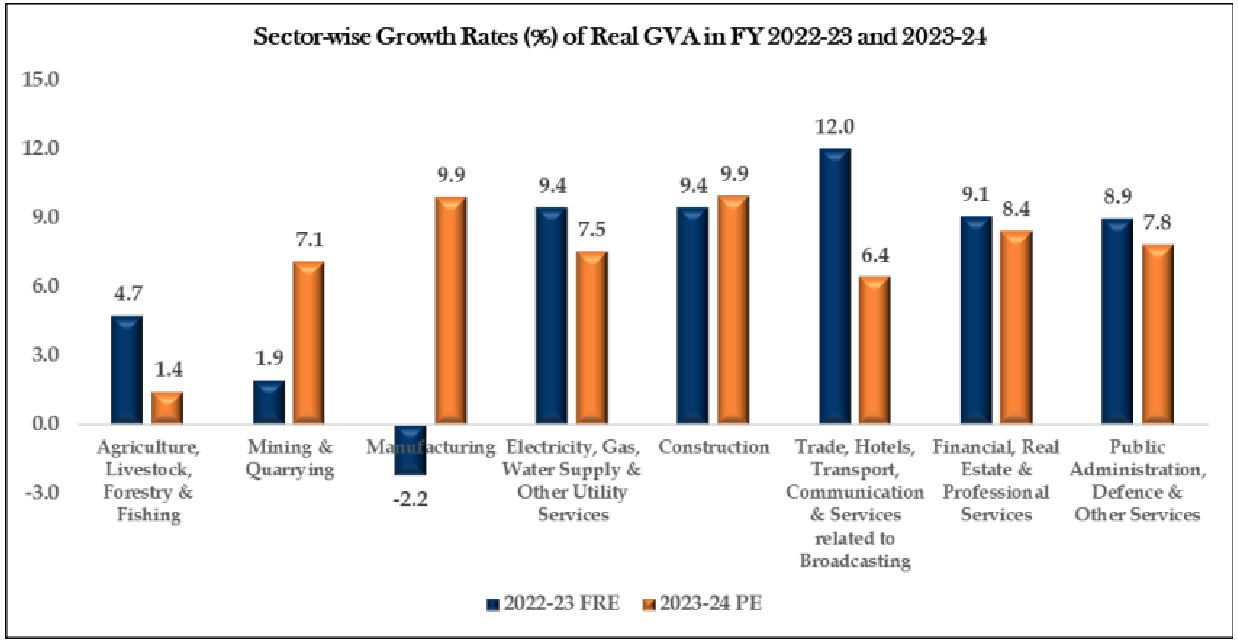
- GDP is a factor of four major components that we will discuss further:



Economic Overview FY24 - *What has happened so far...*

Manufacturing and Services lead growth...

- The economic growth was majorly led by the manufacturing sector;
  - This indicates the success of the Government's focused efforts towards the sector; making investment in manufacturing lucrative, reducing reliance on imports, generating employment for the unskilled workforce, and attracting foreign investments.
  - This was at the back of strong policy measures for MSMEs and reduced input prices, which was passed on to the consumers. This was reflected in both subdued WPI and core CPI.
  - This was also reflected in the manufacturing PMI numbers which consistently remained >50, indicating an expansion.
- This was followed by mining and construction, which again provided growth impetus to manufacturing activity.



Source: Press Note on Provisional Estimates of Annual GDP for 2023-24

- The service sector showed a steady growth with the service PMI consistently expanding above 60 points since Jan-24. This growth was mainly driven by financial services sector and a high export demand for IT services; both of which would contribute to employment generation.

Economic Overview FY24 - *What has happened so far…*

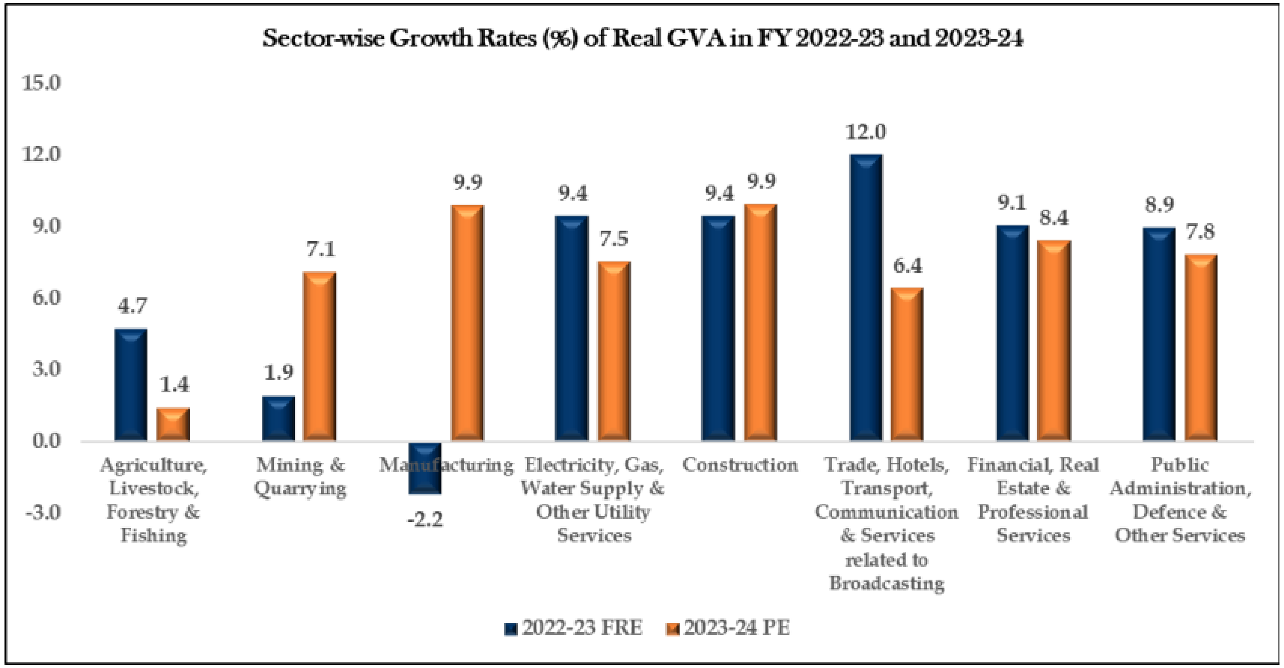
…Agriculture falls back

- At the same time, the agricultural sector continued to grow at a much slower pace, mainly due to poor monsoon leading to decline in food produce.
- This signals a need for more policy reforms and government spending on improving agricultural productivity and easy financing.

Our Take

Can a labour surplus country like India afford to neglect the primary sector which still acts as a bedrock for holistic economic growth of the country?

- The impact of this slowdown can be clearly seen in the decline in rural consumption.
- Rural consumption in India suffered during the pandemic and has grown at a low pace since then as compared to urban demand.
- Some sectors like 2-wheeler vehicles and FMCG did see some growth, however the larger picture still looks gloomy.
- One reason for this is the reverse migration during the pandemic which has increased dependency of people on agriculture as a source of income.



Source: Press Note on Provisional Estimates of Annual GDP for 2023-24

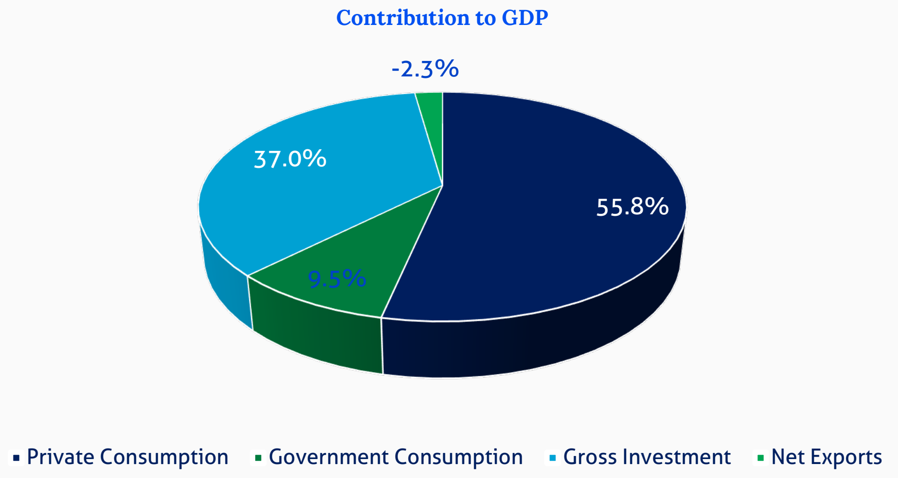
Economic Overview FY24 - *What has happened so far…*

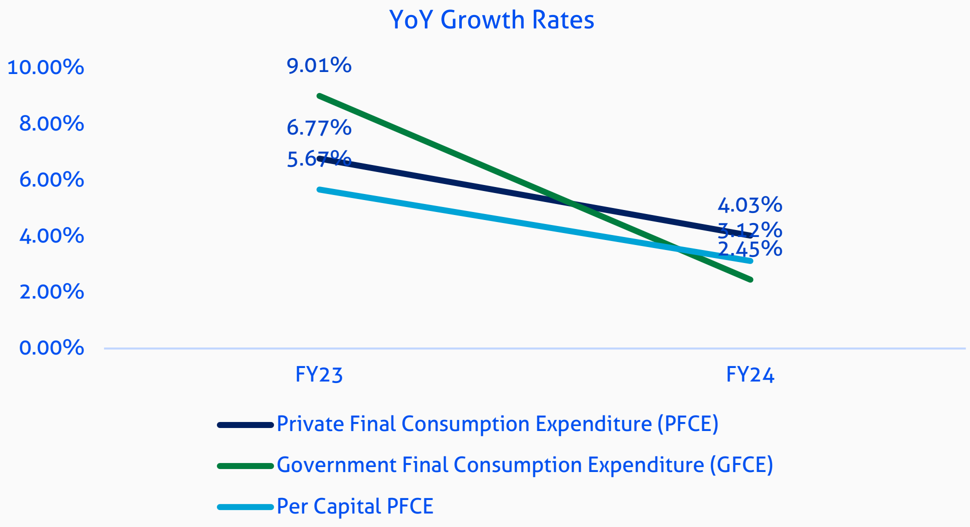
Slowdown in Private and Government Consumption

- The real private and government expenditure grew by 4% and 2.5% respectively in FY24. The same figures in FY23 were 6.8% and 9%, respectively.
- Total consumption forms about 65% of the real GDP and therefore would have the most significant impact on economic growth.
- The per capita Private Final Consumption Expenditure (PFCE) grew by only 3.1% in FY24 as against 5.7% in FY23 indicating a slowdown in consumers spending.

Our Take

- A slow growth in demand can adversely affect the prospects of private investments, and further impair the economy. Hence, measures to boost consumption are paramount for the Government at this junction.
- Possible reasons for this subdued consumption could be:
  - Muted rural demand
  - Increased SIP investment and Capital Market engagement
  - Increased household debt and spending on debt repayment
  - Increase in Food Inflation





Source: Press Note on Provisional Estimates of Annual GDP for 2023-24

Economic Overview FY24 - *What has happened so far...*

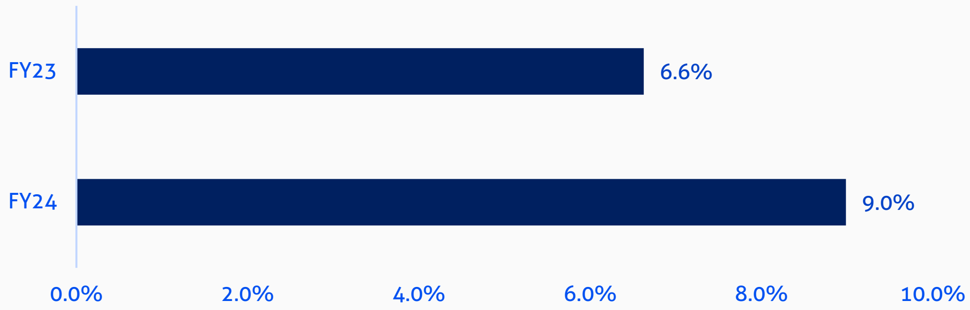
Public and Private investments to the rescue

- The real gross fixed capital formation grew by 9% FY24. The same figure in FY23 was 6.6%. Total investment formed about 37% of the real GDP during the year.
- The growth was backed by public investment of ~Rs. 19 lakh crore an increase of about 27% from FY23. Further, private CAPEX also increased by around 19.8% year on year.

Our Take

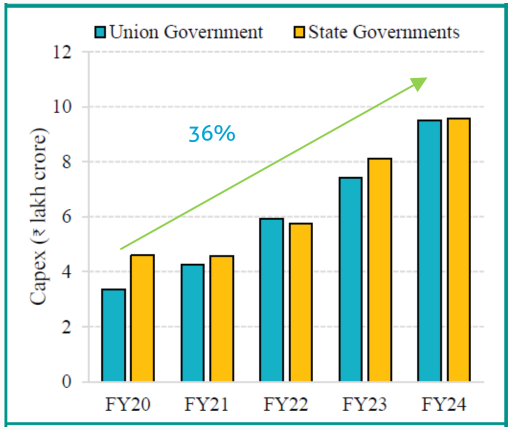
- It is the Government which has been supporting the economy through the Pandemic. Public investment has grown at CAGR of ~36% in last 4 years. As against the above, private investment has grown by a meagre ~11% in the same period. Government's emphasis on public capex was indeed pragmatic as it was meant to not only bolster the GDP but also develop logistics infrastructure to make private investment more lucrative. Govt also offered tax incentives and PLIs to further incentivise private investment. However, no big increase in private investment was observed. Should businesses do more on the investment side to support the government on the capital outlay front?
- One reason of the above reluctance in private investment could be lack of sufficient consumption to make private investment economically possible. But the question is wouldn't more private investment, generate more employment, leading to more consumption!

Gross Fixed Capital Formation Growth

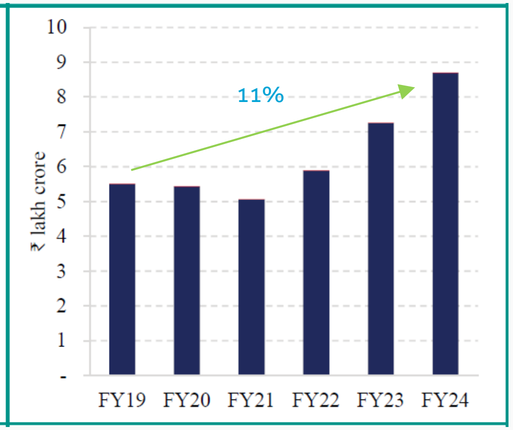


Source: Press Note on Provisional Estimates of Annual GDP for 2023-24

Public Investment



Private Investment



Source: Economic Survey 2023-24

Economic Overview FY24 - *What has happened so far…*

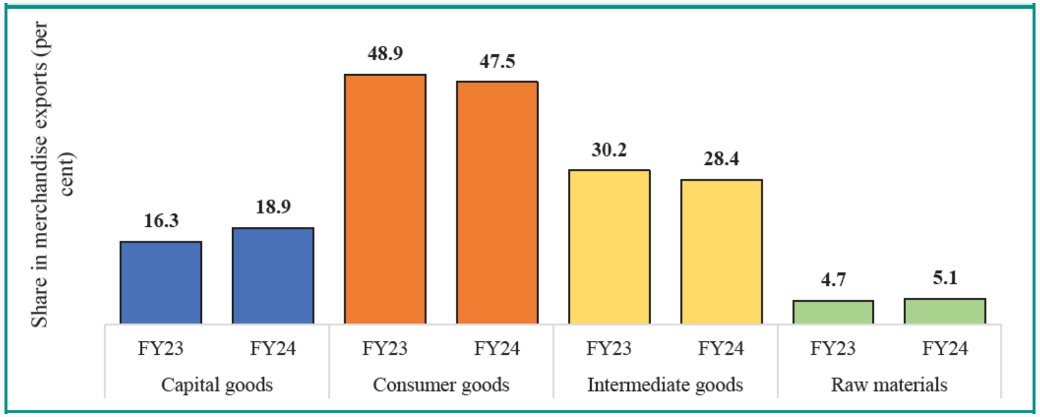
Sharp decline in export growth with an increase in imports

- The exports grew by a meagre 2.63% in FY24 whereas imports grew by 10.4%. For FY23, the corresponding growth rate for export and import was 13.4% and 10.6%, respectively.
- The slow export growth was a result of a weak global demand, especially in EU, which was coupled with lagged impact of monetary tightening in those countries.
- However, green shoots were seen for capital goods exports as the share of the same increased from 16.3% to 18.9% in FY24. India is also reducing geographical dependency by adding more export destinations as the share of top 10 exporting countries has declined from 61.9% in FY00 to 50.5% in FY24.

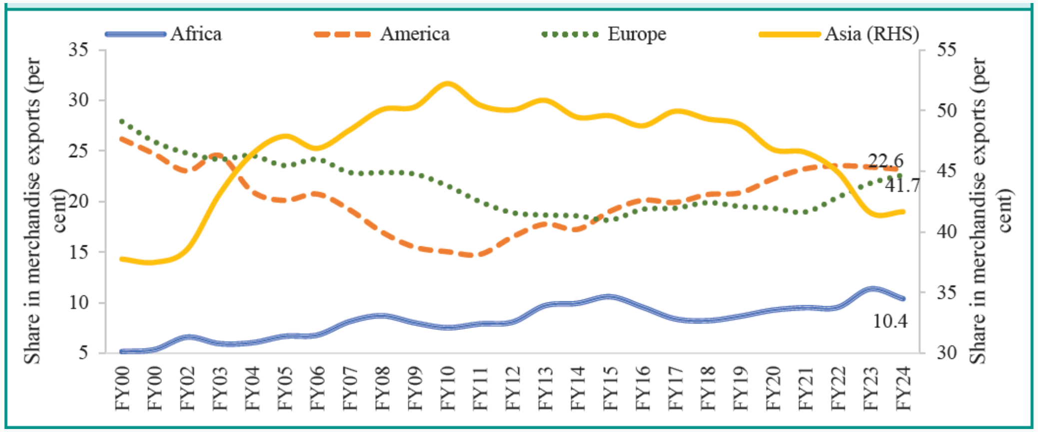
Our Take

- Exports contribute around 23% to the GDP and Government has taken various measures to augment exports from India. Export in developed economies facilitates better pricing, improved profitability and eventually income growth in the economy.
- Government's focus on boosting domestic supply along with export-oriented reforms was intended to make industries add capacity and move towards exports, leading to better margins and higher per capita income in the economy; which would eventually translate into higher consumption and private investment.

Sector wise contribution to exports



Shift in geographical dependence



Source: Economic Survey 2023-24

Economic Overview FY24 - *What has happened so far...*

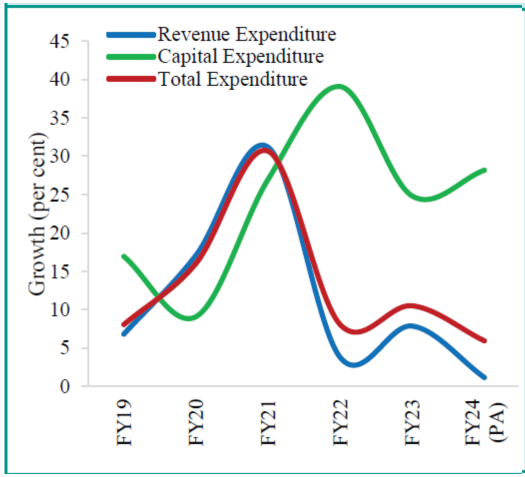
Persistent effort towards fiscal consolidation

- The Government, over past few years, has increased focus towards fiscal consolidation by improving revenue from taxes. Fiscal deficit fell sharply from 6.4% in FY23 to 5.6% in FY24
- Increased tax compliance measures and technology integration in the tax system resulted in an increase in Gross Tax Revenue of 13.4%. Of this, direct tax grew at 15.8% whereas indirect tax grew at 10.6%.

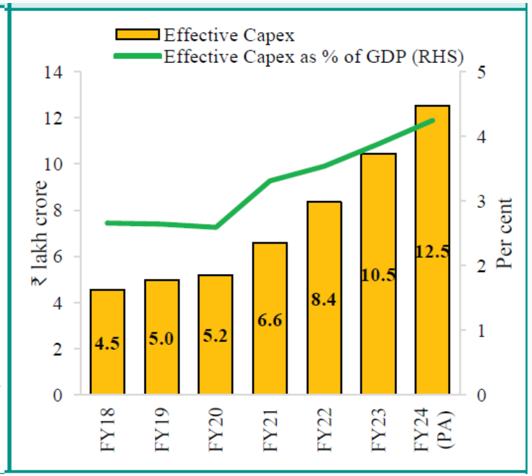
Our Take

- Increased Capex by the Government resulted in a more conservative approach towards revenue expenditure. However, Capex has helped in building the productivity and potential of the economy, thus benefiting the nation in the long run.
- Even state governments are adopting a prudent approach by improving the quality of expenditure, with focus on Capex. State Capex as percentage of GDP has increased from 2.2% to 2.6% in last 4 years.
- A sharp decline in fiscal deficit, allows the Government to reduce its debt dependency, leading to a sustainable interest rate cut, which in turn leads to an increase in investment and consumption opportunities in the economy. A reduced fiscal deficit also makes room for enhanced revenue expenditure in key areas such as health & education along with higher Capex.
- In that spirit, the Government has been quite bold in its push for fiscal consolidation over the last few years which is well justified.

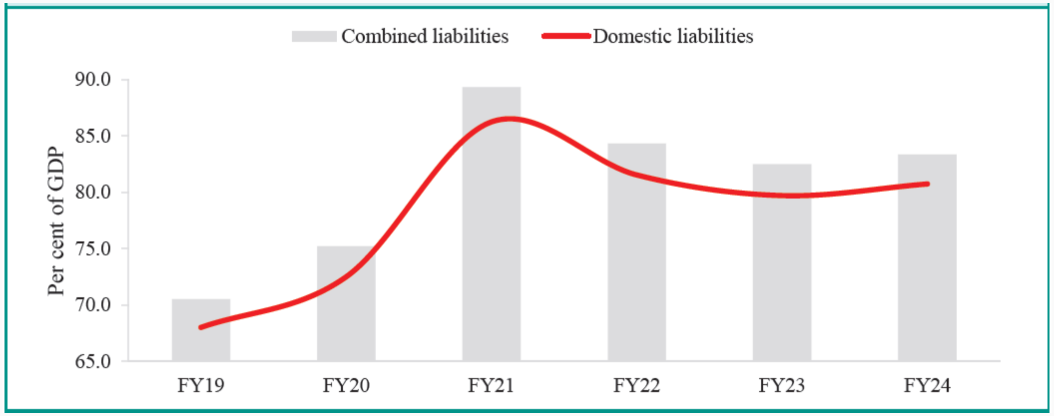
Shift to productive expenditure



Increasing Capex



Easing debt burdens through fiscal consolidation



Source: Economic Survey 2023-24

Economic Overview FY24 - *What has happened so far...*

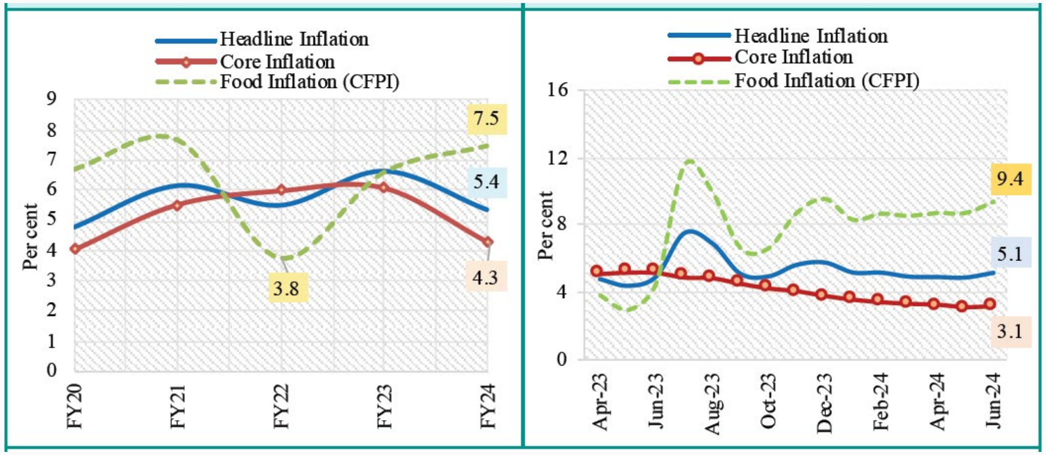
Impressive management of Inflation by the Government

- Headline inflation reduced from 6.7% in FY23 to 5.4% in FY24, despite there being supply chain disruptions from geopolitical tensions.
- Adverse weather conditions resulted in increase in food inflation to ~12% during the FY24.
- Government undertook following measures to control inflation: open market sales, increased repo rates, reduced prices of LPG cylinders, and implemented a cut in petrol and diesel prices.

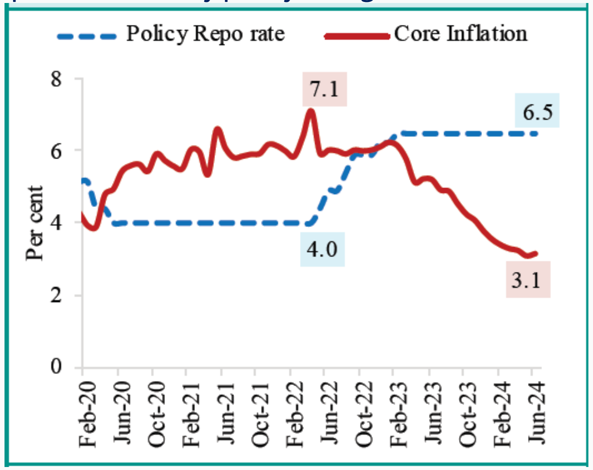
Our Take

- The constant climate induced volatility in food prices needs a long-term strategy to reduce inflation & boost consumption.
- With the target inflation set at 4%, which the Government wants to achieve on a durable basis, possibility of Interest rate cuts in the short run seems bleak.
- The reason behind setting such a tight inflation target despite subdued consumption is excess money in the economy which is not being converted to increased consumption and private investment.
- FY24 saw a sharp increase in retail credit activity with retail loans as a percentage of GDP increasing from 10.7% in 2007-08 to 18.1% in 2023-24, while industrial credit was just 12.4% of GDP. However, as we discussed earlier, India did not observe a commensurate increase in retail consumption.
- The excess household debt is pushing people in the cycle of borrowing to repay existing debt, leaving smaller room for consumption. In such a scenario, it may not be the best decision to further encourage household debt through rate cuts, unless the excess money is channeled in the right direction – i.e. for industrial credit and investment.

Inflation trends in India



Impact of monetary policy changes on core inflation



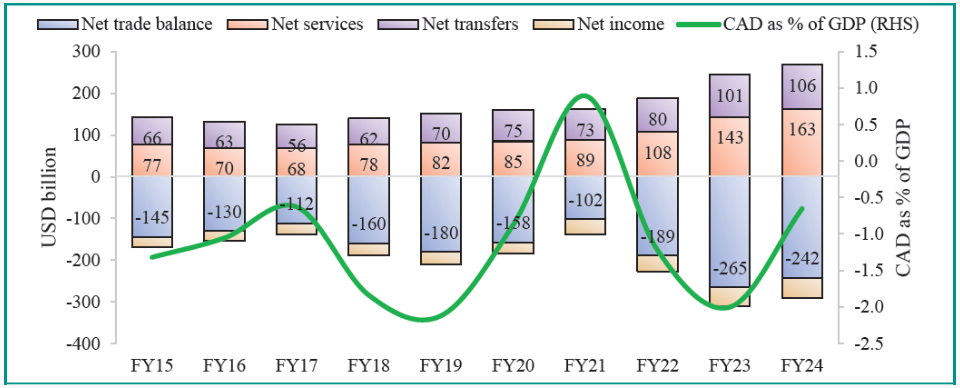
Source: Economic Survey 2023-24

Economic Overview FY24 - *What has happened so far...*

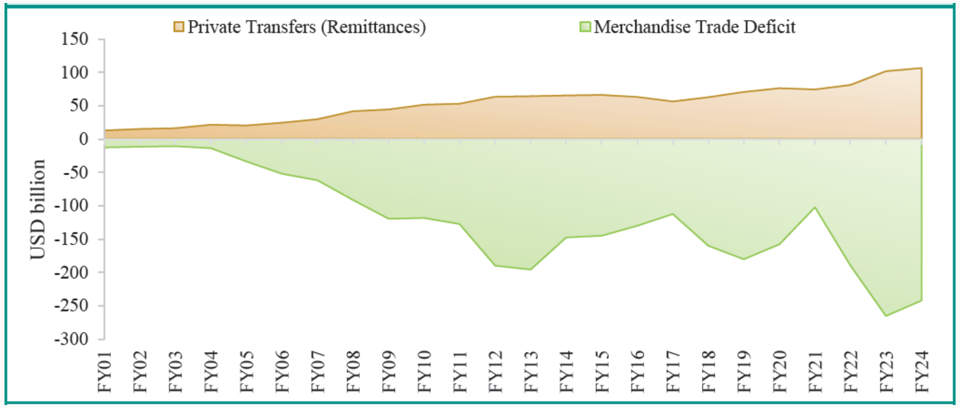
Significant Improvement in Current Account Deficit

- The CAD narrowed to 0.7% of GDP in FY24 from 2% of GDP in FY23, i.e. a reduction of 1300 bps! In fact, in Q4 of FY24, there was current account surplus of 0.6% of GDP.
- The above was a result of a decline in merchandise trade deficit, rising net services exports, and increasing remittances. Reduction in inflationary pressures outside India, helped in the above decline of deficit.
- Remittances by Indians employed outside India, which is the second largest source of financing the deficit, stood at USD 106.6 billion. It must be noted that every year 25 lakh Indians are migrating to foreign countries. This would mean an increased number of remittances would enter India in coming years, providing a more stable source of finance for the government.
- Net FPI inflow during the year has been USD 44.1 billion, assisting in neat build-up of forex reserves. The forex reserves build during FY24 were sufficient to cover 11 months of import and almost 100% of external debt, leading to favourable credit outlook and reducing the default risk of India.
- Resultantly, Indian rupee has been one of the least volatile currencies. It must be noted that India is now part of the JP Morgan Bond Index and therefore would be tracked more closely by foreign investors. This may increase foreign fund inflow in India, resulting in appreciation of Indian rupee. However, an increased visibility of and activity in Indian market may also increase volatility of Indian rupee as it would become more exposed to foreign economic scenarios.

Improvement in CAD



Trade deficit offset by increased remittance



Source: Economic Survey 2023-24

Economic Outlook - *Government's response through the budget*

Boosting consumption without freebies... a sustainable approach

- Weather conditions adversely impacted food prices and impacted consumption in FY24
  - To combat this, 109 high yielding 32 climate resilient varieties of crops will be released
  - Investment in agriculture research for developing climate resilient varieties
- Insufficient storage facilities result in surge in pricing which impacts consumption
  - To combat the same, large-scale clusters for vegetable production will be developed near the consumption centres
- Non-working population will have no income of their own and would eat up family income
  - Improve job creation by providing incentive to employee as well as employer
  - Support employer monetarily for every additional employment created
  - Encourage women participation in workforce by setting up women hostels and creches.
- Unskilled workforce resort to low paying jobs, resulting in reduced income and lower consumption
  - Upgradation of 1000 Industrial training institutes in hub and spoke arrangements
  - Model Skill Loan Scheme to facilitate loans up to 7.5 lakhs
  - Education loans up to 10 lakhs for higher education in Indian institutions
  - Internship opportunity in top 500 companies of India.

Government's pragmatic approach for boosting consumption in a sustainable manner by putting money in the hands of people through rural reforms, employment and upskilling is indeed laudable. This would provide the needed push for increasing demand in the economy and incentivize private investment.

Economic Outlook - *Government's response through the budget*

Continuing the capex push and encouraging private investment

- The Government has committed Rs. 11.11 lakh crore towards Infrastructure investment, which includes building access-controlled expressways, dedicated freight corridors, shipping ports, airports.
  - This not only helps in boosting GDP but also improves productive potential of economy by reducing costs and time taken for movement of goods.
- Pradhan Matri Gram Sadak Yojana for all weather road connectivity to 25,000 rural habitations
- 3 crore additional houses under PM Awas Yojana in rural and urban areas is significant capex commitment by the Government
- Encouraging MSMEs to invest and expand for boosting private investment
  - Credit guarantee scheme for MSME for purchase of plant and machinery on credit without collateral
  - New credit assessment for MSME through digital footprint
  - New SIDBI branches to serve all major MSME clusters
  - Investment ready "plug and play" industrial parks with complete infrastructure near 100 cities
  - 12 new industrial parks under National Industrial Corridor Development Program
  - Facilitating rental housing for industrial workers in PPP mode
- Encouraging private investments by improving ease of doing business and contract enforcement
  - C-PACE for voluntary closure of LLPs
  - IBC reforms for speedy resolution of insolvencies
  - Additional debt recovery tribunals
  - Reducing litigation through Vivad se Vishwas scheme
  - Simplifying the direct tax code.

Not only has Government increased its Capex spend, but it has also now provided boost to consumption as well as improved credit access for MSMEs. This we believe is an "all-round" support by Government for industry to increase private investment.

Economic Outlook - *Government's response through the budget*

Increasing export volumes from India and reducing imports

- Support to MSMEs for entering export markets can help in boosting the export volumes
  - Government to set up E-commerce export hubs in PPP mode to enable MSMEs and traditional artisans to export their products
- Export markets put high emphasis on quality and safety of the product and MSMEs need to adapt to the same
  - 100 food quality and safety testing labs with NABL accreditation will be facilitated
- Certain export markets also place requirement for energy efficient supply in the territory
  - Investment grade energy audit to MSME industries in 60 clusters
  - Financial support to shift to cleaner form of energy and implementing energy efficient measures
- Support domestic manufacturing to reduce import dependency
  - Removal of BCD on oxygen free copper to boost local manufacturing of resistors in electronics industry
  - Increasing BCD on PCBA of specified telecom equipment to encourage local manufacturing and reduce imports.

The Government has taken measures at both ends – encouraging exports as well as reducing dependency on imports. What is crucial is that the measures are not only focused on monetary and fiscal benefits but targeted at improving the export competitiveness of Indian products – in terms of quality and energy efficiency, which is the key in this highly competitive global market.

Economic Outlook - *Government's response through the budget*

Closing on the targeted fiscal consolidation

- Government has set a fiscal deficit target of 4.5% which it seeks to achieve by 2026 whilst considerably reducing the percentage of government debt in GDP.
- The above can be possible by sustaining the tax buoyancy that the Government has cultivated over the past few years through increased compliance and technology integration
  - Improving tax compliance through further incentivizing the new tax regime
  - Removing tax leakages through revised assessment procedures
  - Increasing STT of futures and options to 0.02% and 0.1% respectively
  - Increasing tax collection through Vivad se Vishwas Scheme
- As per the Hon'ble FM, tax revenue of ~Rs. 7,000 crore will be foregone annually in the short run.
- At the same time, it is expected that the increasing economic and capital market activity, coupled with efficient compliance checks, will yield more revenue for the Government.

When we look at the entire macro environment of India in a holistic manner, although GDP growth may be at an all-time high, there are a couple of plaguing issues (consumption and private investment) that need immediate attention. The entire burden of growth is currently on the Government, and it is under extreme pressure to sustain this growth whilst solving for these issues. In such a scenario, fiscal consolidation is extremely necessary to sustain this growth momentum and it is just logical to tighten revenue from taxes rather than increasing debt, which would only add to this pressure.

About *kcm*Compass

*kcm*Compass *is a special publication prepared by the Strategic Advisory team at K C Mehta & Co LLP. This publication is intended to offer periodic economic updates and an overview of policy changes introduced during the period. The idea is to analyze the movement and trends amongst various economic metrices, understand the Government's policies around the same, and analyze the impact of both on business.. This would act as a reckoner for businesses, helping them gauge the direction of the economy and accordingly take necessary action in their decision making.*

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